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IN THE
SUPREME COURT OF THE UNITED STATES
APRIL TERM, 1978

No. 77-1410

William E. Butner, Petitioner,

v.

United States of America, et al., Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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IN THE
SUPREME COURT OF THE UNITED STATES
APRIL TERM, 1978

No. _____

IN THE MATTER OF:

Golden Enterprises, Inc., Bankrupt.

Golden Enterprises, Inc., and William E. Butner, Petitioners,

v.

United States of America, Respondent.

and

IN THE MATTER OF:

Golden Enterprises, Inc., Bankrupt.

Joe Cagle, Trustee in Bankruptcy for Golden Enterprises, Inc.; Attorneys for the Creditors' Committee; James M. Gaither, Jr., Attorney for Bankrupt; Golden Enterprises, Inc., Bankrupt; William J. Lawing, C.P.A., and Charles B. Camp, Respondents,

v.

William E. Butner, Petitioner.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Petitioner, William E. Butner, prays that a writ of certiorari issue to review the judgment herein of the United States Court of Appeals for the Fourth Circuit entered in the above entitled cases on December 8, 1977, petition for rehearing denied on January 6, 1978. The decision reversed the judgment of the United States District Court for the Western District of North Carolina, Statesville Division, which, by decision dated November 12, 1976, declared Petitioner to be a secured creditor with respect to the rents derived from the encumbered property during Bankruptcy and remanded the case for determination of what costs and fees were properly chargeable against these rents.

OPINIONS BELOW

The Bankruptcy Court on July 1, 1976, declared Petitioner to be an unsecured creditor with respect to the rents derived from the encumbered property during bankruptcy. The order of the Bankruptcy Court (Appendix pp. 2a-20a) is unreported. The opinion of the District Court for the Western District of North Carolina, Statesville Division, reversing and vacating the decision of the Bankruptcy Court (Appendix pp. 21a-30a) is unreported. The majority opinion of the United States Court of Appeals for the Fourth Circuit, reversing the judgment of the District Court (Appendix pp. 31a-43a) is not officially reported on this date.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was made and entered on December 8, 1977, and a copy thereof is appended to this petition in the Appendix at pp. 31a-43a. The petition of William E. Butner for a rehearing was denied on January 6, 1978. (Appendix p. 44a) The motion of William E. Butner for a stay of mandate pending the filing of

a petition for Writ of Certiorari was denied on January 16, 1978. (Appendix p. 45a) The jurisdiction of this Court is invoked under 11 U.S.C. § 47(c) and 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. The first question presented is whether the difference in administration of the Federal Bankruptcy law in the various circuits on the question of the ability of a secured creditor to reach the rents from the encumbered property to satisfy his claim, violates the Constitution of the United States.

2. The second question presented is whether, where real property encumbered by a mortgage becomes involved in a bankruptcy proceeding, the mortgage holder may reach the rental income from the encumbered property to satisfy his claim without making any preliminary attempts to take possession of the property.

3. The third question presented is whether the Court below erred in holding that, where a corporation attempts an arrangement under Chapter XI of the United States Code and the arrangement is unsuccessful thus forcing the corporation into a straight bankruptcy proceeding, actions taken under the Chapter XI proceeding by a mortgageholder to establish his right to the rents of the mortgaged property did not establish his claim to the rents for purposes of the bankruptcy proceeding.

4. The fourth question is whether the Fourth Circuit Court of Appeals so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of the United States Supreme Court's power of supervision under U. S. Sup. Ct.

Rule 19(1)(b), 28 U.S.C., when it denied the second mortgageholder's right to the rents from the mortgaged property on the ground that actions taken in a Chapter XI proceeding to establish such rights do not carry over into an ensuing straight bankruptcy while reinstating the judgment of the United States Bankruptcy Court which gave priority over the second mortgageholder's claim to the claims of the respondents herein for fees and expenses generated during the Chapter XI proceeding.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

U.S.C.A. Const. Art. I § 8

The Congress shall have Power ***

Clause 4. To establish an uniform Rule of Naturalization, and uniform laws on the subject of Bankruptcies throughout the United States;

11 U.S.C. §752

Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, where a petition is filed under section 721 of this title and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed under section 722 of this title, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree for adjudication had been entered at the time the petition under this chapter was filed.

11 U.S.C. §776(2)

If the statement of the executory contracts and

the schedules and statement of affairs, as provided by paragraph (1) of section 724 of this title, are not duly filed, or if an arrangement is not proposed in the manner and within the time fixed by the court, or if an arrangement is withdrawn or abandoned prior to its acceptance, or is not accepted at the meeting of creditors or within such further time as the court may fix, or if the money or other consideration required to be deposited is not deposited or the application for confirmation is not filed within the time fixed by the court, or if confirmation of the arrangement is refused, the court shall--

***

(2) where the petition was filed under section 722 of this title, enter an order, upon hearing after notice to the debtor, the creditors, and such other persons as the court may direct, either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this title or dismissing the proceeding under this chapter, whichever in the opinion of the court may be in the interest of the creditors: Provided, however, That an order adjudging the debtor a bankrupt may be entered without such hearing upon the debtor's consent.

Rules Bankr. Proc. Rule 201(a)

Purposes and Term of Receivership. Subject to the provisions of this rule, the court may appoint a receiver when necessary in the best interest of the estate (1) to take charge of the property of a bankrupt; (2) to conduct the business of the bankrupt; or (3) to afford representation to the estate in an action, adversary proceeding, or contested matter when no trustee has qualified or the interest of the trustee may be adverse to that of the estate. Such appointment shall be terminated when the trustee qualifies or there is no further need for a receiver, and the authorization to conduct the business of the bankrupt after

adjudication shall continue only for such time as may be in the best interest of the estate and consistent with orderly liquidation.

Rules Bankr. Proc. Rule 701, 11 U.S.C.

The rules of this Part VII govern any proceeding instituted by a party before a bankruptcy judge to (1) recover money or property, other than a proceeding under Rule 220 or Rule 604, (2) determine the validity, priority, or extent of a lien or other interest in property, (3) to sell property free of a lien or other interest for which the holder can be compelled to take a money satisfaction, (4) object to or revoke a discharge, (5) obtain an injunction, (6) obtain relief from a stay as provided in Rule 401 or 601, or (7) determine the dischargeability of a debt. Such a proceeding shall be known as an adversary proceeding.

Rules Bankr. Proc. Rule 601(e), 11 U.S.C.

(e) Availability of Other Relief. Nothing in this rule precludes the issuance of, or relief from, any stay, restraining order, or injunction when otherwise authorized.

Advisory Committee's Note

***

Subdivision (e). The stay provided by this rule is in no way a limitation on the discretion and power of the court of bankruptcy under §2a(15) of the Act [section 11(a)(15) of this title] to grant or deny or modify relief in the nature of an injunction.

U.S. Sup. Ct. Rule 19(1)(b), 28 U.S.C.

1. A review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor. The following, while neither controlling nor fully measuring the court's discretion, indicate the character of reasons which will be considered:

***

(b) Where a court of appeals has rendered a decision in conflict with the decision of another court of appeals on the same matter; or has decided an important state or territorial question in a way in conflict with applicable state or territorial law; or has decided an important question of federal law which has not been, but should be, settled by this court; or has decided a federal question in a way in conflict with applicable decisions of this court; or has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this court's power of supervision.

11 U.S.C. §778

(a) Upon the entry of an order directing that bankruptcy be proceeded with--

***

(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effects if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed by the court;

***

STATEMENT OF THE CASE

William E. Butner, Robert L. McKaughn, Jr., and Jack Sipe Construction Company held a second mortgage in the amount of $360,000.00 on real property

owned by Golden Enterprises, Inc., a North Carolina Corporation. Since that time Robert L. McKaughn, Jr., and Jack Sipe Construction Company have assigned all of their right, title and interest in the indebtedness and deeds of trust to William E. Butner, the Petitioner herein, thus making him the sole second mortgageholder.

On May 4, 1973, Golden Enterprises, Inc., filed a petition in bankruptcy for an arrangement under Chapter XI of the Bankruptcy Act, 11 U.S.C. Section 701, et seq. While the Chapter XI proceeding was pending, on April 7, 1974, upon motion by William E. Butner, Robert L. McKaughn, Jr., and Jack Sipe Construction Company to secure the debt to them in the amount of $360,000.00, and upon their agreement that they would not attempt to foreclose their deed of trust without Court approval, the Honorable Joseph R. Cruciani, Bankruptcy Judge, ordered that the note and deed of trust to them from Golden Enterprises, Inc., should be in the original amount of $360,000.00, reduced the rate of interest from twelve percent to ten percent per annum and further ordered "That the holders of the note or any assignee thereof shall not attempt to file a petition to reclaim or to foreclose except upon motion to this Court setting forth the reasons therefor."

On April 17, 1974, the first and second mortgageholders sought the appointment of an agent to collect the rental income from Golden Enterprises' property. On April 18, 1974, the Honorable Joseph R. Cruciani, Bankruptcy Judge, appointed Simon Joseph Golden as agent "to receive all income derived from debtor's real estate" and to apply that income to the payment of interest and principal on the second mortgage as well as to other enumerated debts of the corporation.

A plan of arrangement was never confirmed, and on February 14, 1975, Golden Enterprises, Inc., was adjudged a bankrupt, and the Honorable Joseph R. Cruciani appointed Joe N. Cagle as Trustee to take charge of the real estate and "to collect and receive all rents, issues, income and profits . . . due or to become due to the within estate, and to hold and retain all monies thus received to the end that the same may be applied under this or different or further orders of this Court . . . ."

The first mortgage payments had been kept current during the Chapter XI proceeding, but in February, 1975, the Trustee ceased making payments on the first mortgages, allegedly pursuant to an oral order issuing from someone in the office of the Bankruptcy Judge, although there is no direct evidence that any such further order was entered.

There now remains in the Trustee's hands approximately $162,971.32, all of which is rental income from the real property since the personal property was disposed of during the Chapter XI proceeding and its proceeds paid out to some creditors.

During the Bankruptcy proceeding, the second mortgageholder orally sought abandonment of the property to him. The Bankruptcy Judge gave repeated oral assurances to the second mortgageholder that, if, when the property was sold, the sale did not bring enough money to pay the first and second mortgage debts, he would not confirm the sale but would abandon the property. In the meantime, the Judge refused to abandon the property. At the first meeting of the creditors, the second mortgageholder sought abandonment, and the Judge indicated that he would abandon the property if the sale proceeds were insufficient to pay the mortgage debts and indicated in addition that

he was refusing to abandon the real estate because of his concern over how the costs of administration would be paid.

The real estate was sold at public auction on July 28, 1975, and the sale of two of the tracts was confirmed. William E. Butner appealed to the United States District Court for the Western District of North Carolina, Statesville Division.

After hearing the appeal, the Honorable Woodrow W. Jones, Judge, on November 7, 1975, ordered the Trustee to resell the real estate at public auction free and clear of all liens and encumbrances except the first deeds of trust thereon. Judge Jones further ordered that the second mortgageholder be allowed to use the outstanding principal balance of his Deed of Trust to bid at the bankruptcy resale.

At the resale, November 12, 1975, William E. Butner became the last and highest bidder for the property, with a bid of $174,000.00, thus leaving a balance due on his note of $186,000.00. However, at the final meeting of creditors to determine the distribution of the $162,971.32 in rents held by the Trustee, the Honorable Marvin R. Wooten, Bankruptcy Judge, declared the second mortgageholder a general creditor with respect to the balance due on his note while awarding, almost without exception, all claims arising during the Chapter XI proceeding as priority claims.

William E. Butner appealed this order to the United States District Court for the Western District of North Carolina, Statesville Division, where the Honorable Woodrow W. Jones, Chief Judge, reversed and vacated the Bankruptcy Judge's finding of William E. Butner's unsecured status as to the rents derived from the encumbered property. From this order the

United States and the Trustee, et al. appealed to the United States Court of Appeals for the Fourth Circuit where the United States' appeal on its tax claim was consolidated with the appeal of the Trustee, et al. for briefing and argument. The appeal was heard on October 4, 1977, and on December 8, 1977, the Fourth Circuit Court of Appeals, Senior Circuit Judge Bryan dissenting, reversed the judgment of the United States District Court and remanded the case for compliance with the final order of Judge Wooten. William E. Butner's petition for a rehearing was denied on January 6, 1978, and his motion for a stay of mandate pending petition for writ of certiorari to the United States Supreme Court was denied on January 16, 1978.

I.

Certiorari should be granted to resolve a split of authority among the United States Circuit Courts of Appeals which split is contrary to the provisions of the Constitution of the United States.

Article I, Section 8, Clause 4 of the United States Constitution empowers Congress "to establish... uniform Laws on the subject of Bankruptcies throughout the United States." Congress has established such a uniform law. If the Constitution orders the establishment of a uniform law, then it follows that the law must also be uniformly applied throughout the United States. At present, however, the law is not being consistently applied on the question of the right of a secured creditor to reach the rents of the encumbered property to satisfy his claims.

There is a split of authority among the circuits as to whether a secured creditor may satisfy his claim in bankruptcy out of the accrued rents of the encumbered property after the proceeds of the foreclosure

sale of that property have been exhausted. The Third and Seventh Circuits allow a secured creditor to reach the rental income. In re Pittsburg Duquesne Development Co., 482 F.2d 243, 246 (3d Cir. 1973); In re Wakey, 50 F.2d 869 (7th Cir. 1921). The Eighth and Ninth Circuits hold that the mortgagee has no right to the rents unless he has taken possession of the property, and, since a mortgagee cannot take possession of the property if the bankruptcy court has assumed control of it, in cases of bankruptcy, these circuits substitute other actions by the mortgagee in lieu of taking possession to secure his rights in the rental income. Tower Grove Bank & Trust Co. v. Weinstein, 119 F.2d 120 (8th Cir. 1941); In re Hotel Saint James Co., 65 F.2d 82 (9th Cir. 1933). These substituted acts encompass petitioning for a sequestration order, getting a receiver appointed to collect the rents or obtaining the court's consent to a foreclosure. Pollack v. Sampsell, 174 F.2d 415 (9th Cir. 1949); Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930); 4A Collier on Bankruptcy (14th ed.) ¶70.16 at 150-163 (1976).

The fact that courts sitting in different circuits can reach completely contradictory results on similar fact situations clearly shows that the policy behind the Constitutional provision on uniformity of bankruptcy laws is being violated. The writers of the Constitution considered this area so vital that they proposed a complete, strictly Federal remedy to assure fair treatment to all involved in bankruptcy. Given their emphasis on uniformity, the anomalies contained in the property law of the individual states should not be allowed to create differences in application of the bankruptcy laws.

This question is of great importance today because of the new wave of bankruptcy proceedings re-

sulting from the economic dislocations of the past decade. Previously, the annual number of bankruptcies nationwide had been relatively small and the unfairness of unequal application of the law less damaging to the population in general. However, if the present split between the Circuits is not resolved, the unfairness of this unequal treatment will now affect a much larger segment of the population since the number of bankruptcies has increased.

II.

In a Bankruptcy situation the mortgageholder should be allowed to satisfy his claim from the rents of the encumbered property without having to make preliminary attempts to obtain possession of said property.

The Fourth Circuit in its opinion in the instant case adopted the rule of the Eighth and Ninth Circuits and held that Petitioner had not performed sufficient acts to establish a claim to the rents from the encumbered property. If the Court rules that the split among Circuits must be reconciled, it is submitted that the rule of the Third and Seventh Circuit Courts of Appeals on this question is the more logical in the context of bankruptcy.

The Fourth Circuit rule furthers the games-playing approach to litigation which the courts, the Congress and the legislatures of the states have been attempting to do away with by revision of the rules of civil procedure and other statutes with an emphasis on the consideration of substance over form and on the idea that a worthy claim should not be defeated by a technical rule in a situation where the rule has no rational application. Under the rule adopted here, a creditor who has not read the fine print about the split

between the circuits on this issue or whose lawyer is not highly specialized in bankruptcy law, is penalized for failing to do something which he would not have to do if the property in which he holds a security interest were located in another state. Thus differences in state rules cause unnecessary inequities in a purely Federal proceeding.

This rule is only applicable in cases where the land has depreciated in value to the point that its sale would not bring enough to cover the mortgage debt. The idea behind requiring a mortgageholder to take possession of the encumbered property before he could reach its rents to satisfy his claim is that, if the value of the land is depreciating because of the debtor's mismanagement, the taking of possession by the creditor would alleviate the problem. Thus, the deficiency would not continue to grow and some of the rents might be freed for application to other debts.

The debtor-mismanagement idea has no validity in Bankruptcy where the property is under the control and supervision of the Court. A possible justification for applying this rule in a Bankruptcy context is that, in a situation where there are many claims and few assets, it gives an indication of the diligence with which a creditor is pursuing his claim and rewards the one who pursues his claim the most vigorously. This application of the rule is unfair. By making the effort and incurring extra expense to obtain security for his debt, a secured creditor has already indicated a diligence which is not shown by the unsecured creditors. Of course there must be enough action on the part of the creditor to make it clear that he has a claim and is not waiving it, but when the newly-adopted Fourth Circuit rule is applied, it turns the Bankruptcy proceeding into a game with all the unsecured creditors waiting to pounce on the assets if a secured creditor

fails to satisfy every technical requirement along the way and ignores the fact that his original efforts to secure his debt at its inception should entitle him to some priority.

This rule discounts the importance of the income-producing capacity of the property in connection with the mortgage transaction. The ability to produce income is one variable in the determination of the value of a piece of property prior to taking a mortgage on it. If the property could not be rented or if no business could be operated thereon, the amount for which the property could be mortgaged would be less. In making a loan and taking a mortgage on real estate, the lender looks in great measure to the income being produced by the property to see if the mortgagor can make the mortgage payments from that income. The ordinary lender does not enter into a mortgage transaction with the idea that the mortgagor will be unable to repay the loan, thus making foreclosure necessary, since foreclosure is an extreme and expensive way of obtaining possession of a piece of property to satisfy a debt. Given that the income-producing ability of a piece of real estate is a prime consideration in the acceptance of a mortgage on that property as security for a loan, it seems only fair that a secured party be able to satisfy a claim in bankruptcy from accrued rents attributable to that property once the proceeds of the foreclosure sale of the property have been exhausted.

The rule adopted by the Eighth and Ninth Circuits, and now by the Fourth Circuit, assumes that a secured creditor is irrational. No rational person would purposely decide not to seek full repayment of a secured debt when he learns that his debtor is in such financial difficulty that he will be unable to pay all of his debts. By adopting this rule the Circuits are trying to penalize a secured creditor in cases where

his security, through no fault of his own, has declined drastically in value. The decline in value of the security does not diminish the amount of money that the secured creditor loaned, and he should not be penalized for value fluctuations where the rents from the property have been collected and are thus available to satisfy his claim.

III.

In holding that actions by the Petitioner during a Chapter XI proceeding to establish his right to the rental income from the property on which he held a mortgage were insufficient to establish that right in the ensuing straight bankruptcy proceeding because the Chapter XI and straight bankruptcy proceedings are not connected, the United States Court of Appeals for the Fourth Circuit committed error in that it misapprehended the nature of the two proceedings and ignored an order by the Bankruptcy Judge which would support a carryover between the two proceedings here. Certiorari should be granted so that the Court can articulate the nature of the relationship, if any, between a Chapter XI proceeding and a straight bankruptcy. In the alternative, the Fourth Circuit Court of Appeals erred in holding that actions taken before bankruptcy did not establish the Petitioner's right to the rents, and certiorari should be granted to correct the Court's interpretation of the Federal case law on this point.

Even if the Eighth and Ninth Circuit rule discussed in II above was correct, the Fourth Circuit Court of Appeals committed error in holding that the second mortgageholder had not satisfied the requirements of that rule.

The Eighth and Ninth Circuits, and now the

Fourth Circuit, when determining if a secured creditor has established his right to the rental income from the encumbered property, consider the following four factors: (1) the nature of the mortgage transaction under applicable state law; (2) the terms of the mortgage itself; (3) the acts of the parties thereunder and (4) whether equitable considerations as applied by the federal bankruptcy court may alter the result. 4A Collier on Bankruptcy (14th ed.) ¶70.16 at 157 (1976).

(1). According to North Carolina law, even after default, the mortgagor is entitled to the rents and profits of the encumbered property until the mortgagee takes possession of the property. After taking possession the mortgagee is entitled to the rents and profits. Gregg v. Williamson, 246 N.C. 356, 98 S.E. 2d 481 (1957).

(2). The terms of the mortgage itself do not address this issue and thus provide no help in determining it.

(3). Here, before Golden Enterprises began the Chapter XI proceeding, the second mortgage was not in default so the mortgagees could not have taken possession. At the time that the Bankruptcy Judge confirmed the amount of the second mortgageholders' claim against Golden Enterprises, Inc., the second mortgage was still current, so they could not have taken possession of the property at that time. In his order, the Bankruptcy Judge ordered also that the second mortgagees not attempt to file a petition to reclaim or to foreclose except upon motion to the Court. Thus, after that time the second mortgageholders could not take possession of the property without permission.

Since the property was under the control of the Bankruptcy Court, Petitioner had to perform one of

the acts which have been held to substitute for taking possession of the property where that is impossible. He satisfied this requirement by obtaining the appointment of a receiver to collect the rents. Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930). The first and second mortgageholders obtained the appointment of Simon Joseph Golden to collect and hold the rents and to make payments on the mortgages. Under the order of the Bankruptcy Judge, there was no other course of action open to them.

At the time when the Chapter XI proceeding was converted into a straight bankruptcy proceeding, the Bankruptcy Judge appointed a Trustee and ordered him to collect and hold all the rents so that they might be applied "under this, or different, or further orders of this Court (emphasis supplied)." Petitioner submits that this order continued the effectiveness of the order in the Chapter XI proceeding which commanded the second mortgageholders not to attempt to reclaim or foreclose the property. Therefore, Petitioner could have done nothing more to establish his right to the rents without risking being held in contempt of court. It also continued the effect of the order appointing a receiver so that the collected rents were held in part for the same purposes as they were in Chapter XI. In addition, Bankruptcy Rule 201(a) provides that, once a Trustee has been appointed, a Receiver may only be appointed "to afford representation to the estate in an action, adversary proceeding, or contested matter when . . . the interest of the Trustee may be adverse to that of the estate." This clearly does not apply here because the mortgageholder would not have sought appointment of a receiver to represent the estate and because the Trustee's interests were not adverse to those of the estate in this situation.

The second mortgageholder was still under the order of the Bankruptcy Judge not to attempt to reclaim or foreclose on the property without permission of the Court, and his oral motions for abandonment were repeatedly denied. In addition he relied on assurances given by the Bankruptcy Judge in chambers and indicated at the first meeting of creditors that, if the property did not bring enough at the foreclosure sale to cover the first and second mortgage debts, the Judge would abandon the property to the second mortgageholders. Thus he could not file an adversary proceeding and did not think that such a proceeding was necessary under the circumstances. This was not a situation where Bankruptcy Rule 701 demands that an adversary proceeding be filed. The only applicable portion of the rule is subsection (6) "to obtain relief from a stay as provided in Rule . . . 601 . . . ." Bankruptcy Rule 601(e) states, "Nothing in this rule precludes the issuance of, or relief from, any stay . . . when otherwise authorized." The note of the advisory committee, with respect to this subsection, explains that "the stay provided by this rule is in no way a limitation on the discretion and power of the court of bankruptcy under §2a(15) of the Act to grant or deny or modify relief in the nature of an injunction."

Thus Petitioner's failure to file an adversary proceeding did not bar him from claiming the rents if his other actions were sufficient to establish a right to the rents.

The Fourth Circuit Court of Appeals held that Petitioner's acts were not sufficient to establish his right to the rents because they were not performed "during bankruptcy." (Appendix p. 36a) Petitioner submits, that, if these acts were not performed "during bankruptcy," he has established his right to the rents because, if the Chapter XI proceeding is not considered

a part of the bankruptcy, then he obtained the appointment of a receiver prior to bankruptcy. According to Collier on Bankruptcy, "If therefore, prior to bankruptcy, the mortgagee has secured possession, commenced foreclosure proceedings, secured the appointment of a receiver for the property, or has in any other manner acceptable under the mortgage and applicable state law sequestered or attached the rents and profits, it is clear under the rule just stated that the mortgagor's trustee has no rights as to such rents and profits from the property when bankruptcy ensues (emphasis supplied)." 4A Collier on Bankruptcy (14th ed.) ¶70.16 at 159-161 (1976), citing as authority Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930); New Orleans Compress, Inc. v. Katz, 185 La. 723, 170 So. 244 (5th Cir. 1936); Central States Life Ins. Co. v. Carlson, 98 F.2d 102 (10th Cir. 1938); First Savings Bank v. Stuppi, 2 F.2d 822 (8th Cir. 1924).

In the alternative, Petitioner submits that the Chapter XI proceeding and the straight bankruptcy proceeding are in fact part of the same bankruptcy so that actions taken during the Chapter XI proceeding are taken "during bankruptcy" for purposes of the rule involved here.

"Once bankruptcy has begun, the mortgagee may, if he has done nothing up to that time, take the following steps to secure the rents and profits: (1) obtain from the bankruptcy court the appointment of a receiver to collect the rents for the benefit of the mortgagee...." 4A Collier on Bankruptcy (14th ed.) ¶70.16 at 161 (1976), citing as authority Tower Grove Bank & Trust Co. v. Weinstein, 119 F.2d 120 (8th Cir. 1941).

Chapter XI is only one portion of the larger Bankruptcy title of the United States Code, 11 U.S.C.

§1 et seq., and is thus encompassed thereby. Rights, duties and liabilities of creditors are the same in Chapter XI proceedings as in straight bankruptcy proceedings. 11 U.S.C. §752. If an arrangement under Chapter XI is not confirmed, the court may adjudge the debtor to be a bankrupt and direct that straight bankruptcy be proceeded with pursuant to the provisions of Title 11 of the United States Code. 11 U.S.C. §776(2). When a Chapter XI proceeding is converted to straight bankruptcy, the proceeding is handled as if the adjudication of bankruptcy was entered when the Chapter XI petition was first filed. 11 U.S.C. 778(a)(2). Thus obviously Chapter XI proceedings are on a continuum with straight bankruptcy and can be considered as a part of "bankruptcy proceedings."

Here the same Bankruptcy Judge dealt with both proceedings and the same debtors were involved in both. Thus it cannot be argued that any party lacked notice of the Petitioner's actions with respect to his second mortgage during the Chapter XI proceeding. There was no prejudicial surprise here to justify holding that the Chapter XI proceeding was not a part of the bankruptcy for purposes of establishing Petitioner's claim to the rents here.

(4). The Trustee et al. argued below that equitable considerations should bar Petitioner from reaching the rents here because he sold one of the pieces of property obtained at the Bankruptcy Resale for one million dollars. The Court of Appeals for the Fourth Circuit apparently relied on this argument to some extent in its decision below. (Appendix p. 37a) Petitioner maintained and still maintains that the question at issue was merely whether his actions had been sufficient to establish the right to reach the rents to satisfy any deficiency and not what the amount of that deficiency might be since the part of the order which

was originally appealed was that which declared him an unsecured creditor with respect to the balance of his claim. He also maintained, and still maintains, that any profit made on the later sale is not relevant to the determination of the deficiency owed. Petitioner was not the sole bidder at the bankruptcy resale; thus the final bid at the resale represents the actual value of the property encumbered by a first mortgage which was badly in arrears. Petitioner subsequently made payments on the first mortgage and eventually paid it off, thus increasing the value of the property by his own efforts. At the same time, the value of the land increased sharply because there was a warehouse on it and there was a shortage of warehouse space in the area. These intervening factors alone should account for any profit made on the sale. However, even if the deficiency owed him is reduced by the sale profits, he will still be able to establish a deficiency in the amount of at least $57,774.55 if he is adjudged to have established a right to reach the rents in question.

The property in question was sold for one million dollars. However, after he obtained possession of the property, Petitioner made payments in the amount of $839,774.55 on the outstanding first mortgage, which was greatly in arrears. Through a lawsuit for recovery of improper charges made on that mortgage and another from the same lending institution, which suit was settled in January, 1978, he recovered $5,000.00 attributable to improper charges made on the loan on the property which he sold. Thus he made a profit of no more than $165,225.45 on the sale. The original mortgage debt owed him was $360,000.00. It was reduced to $190,000.00 by virtue of his $170,000.00 bid at the bankruptcy resale. The loan carried interest at twelve percent, but the Bankruptcy Judge had reduced it to ten percent. During the Chapter XI proceeding, there was no interest paid for at least one month. This

non-payment caused Butner and the others to have a receiver appointed. After the adjudication of bankruptcy, ten monthly interest payments were missed before Petitioner obtained title to the property. At ten percent interest, this means that Petitioner did not receive $33,000.00 in interest payments to which he was entitled. Thus the unsatisfied amount of his debt after the bankruptcy resale was $223,000.00. Simple arithmetic shows that, without allowing anything for expenses incurred by the Petitioner in connection with pursuing his claim in the Bankruptcy proceeding, and without attributing any of the profit from the sale of part of the land to Petitioner's own efforts and a shift in market conditions, he is still owed at least $57,774.55 on his second mortgage. Thus, it is submitted that no equitable considerations should bar his claim to the rents.

IV.

The Fourth Circuit Court of Appeals in its decision so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court's power of supervision under U.S. Sup. Ct. Rule 19(1)(b), 28 U.S.C.

There is an inescapable contradiction in the opinion of the Fourth Circuit Court of Appeals here. On the one hand they rule that a Chapter XI proceeding is not a part of the Bankruptcy proceeding insofar as Petitioner is concerned in that Petitioner's actions during the Chapter XI proceeding will not carry over to secure a claim to the rents in the Bankruptcy proceeding. On the other hand, in reinstating the Order of Bankruptcy Judge Marvin R. Wooten (Appendix pp. 2a-20a), they are ruling that, insofar as Respondents are concerned, a Chapter XI proceeding is a

part of the Bankruptcy proceeding since that Order allowed priority to claims arising out of the Chapter XI proceeding. The order of Judge Wooten awarded Trustee fees of $2,088.99, attorney fees and expenses for the Trustee's attorney of $9,207.07, and a wage claim of $600.00 all of which were properly attributable to the Bankruptcy itself. It then awarded fees and expenses of $ 44,249.52 ($39,623.00 of which was incurred during the Chapter XI proceeding) to the Debtor's attorney; fees and expenses of $4,725.00 ($4,575.00 of which was incurred during the Chapter XI proceeding) to J. Carroll Abernethy; $8,000.00 (all of which was incurred during the Chapter XI proceeding) to the attorneys for the Creditors' Committee; $4,137.25 in accountant's fees (all of which was incurred during the Chapter XI proceeding); and $26,451.77 to a contractor for installing a sprinkler system in one of Golden Enterprises' buildings during the Chapter XI proceeding.

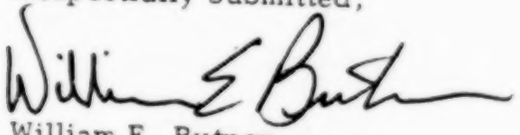
The nature of the relationship between Chapter XI and straight bankruptcy cannot fluctuate depending on whose rights are involved. The same interpretation of the relationship must be applied both to the above claimants and to the Petitioner.

This contradiction in the opinion of the Fourth Circuit Court of Appeals is obvious and cannot be resolved. Thus the United States Supreme Court should grant certiorari, exercising its power of supervision over the lower courts to remove this contradiction.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,



William E. Butner
Attorney for Petitioner
Post Office Box 2323
Hickory, North Carolina 28601

CERTIFICATE OF SERVICE

The undersigned hereby certifies that he has this day served a copy of the foregoing Petition for Certiorari upon counsel for the Appellants by depositing copies of the same in the United States mail, postage prepaid, addressed:

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Solicitor General
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Washington, D. C. 20530 (sent Air Mail)

This the 28th day of March, 1978.

William E. Butner

IN THE

SUPREME COURT OF THE UNITED STATES

APRIL TERM, 1978

No. _____

IN THE MATTER OF:

Golden Enterprises, Inc., Bankrupt.

Golden Enterprises, Inc., and William E. Butner, Appellees,

v.

United States of America, Appellant.

and

IN THE MATTER OF:

Golden Enterprises, Inc., Bankrupt.

Joe Cagle, Trustee in Bankruptcy for Golden Enterprises, Inc.; Attorneys for the Creditors' Committee; James M. Gaither, Jr., Attorney for Bankrupt; Golden Enterprises, Inc., Bankrupt; William J. Lawing, C.P.A., and Charles B. Camp, Appellants.

v.

William E. Butner, Appellee.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

APPENDIX

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
STATESVILLE DIVISION

BANKRUPTCY NO. ST-B-73-6

In the Matter of:

GOLDEN ENTERPRISES, INC.,
Bankrupt.

ORDER

THIS CAUSE coming on to be heard before the undersigned Bankruptcy Judge on June 4, 1976, upon Notice of Final Meeting duly and properly given to the creditors of the above-named Bankrupt, to consider applications for allowances of the Trustee, the Attorney for the Trustee, the Attorney for the Debtor during the Chapter XI proceedings, the Attorneys for the Creditors' Committee, the accountant for the Debtor, and a contractor's claim during the Chapter XI, and to further consider the Trustee's objections to allowances of claims, and certain other matters relating to distribution of proceeds, and the Court having heard the evidence, the contentions of the parties, the arguments of Counsel, and having examined the Court files, hereby enters its findings, conclusions and judgment as follows:

1. That on May 4, 1973, Golden Enterprises, Inc., filed a Petition in Bankruptcy for an Arrangement under Chapter XI. The Chapter XI proceeding was somewhat unique and complex, involving many adversary proceedings, negotiations, Court hearings, liquidation of most of the Bankrupt's personal property, and the payment of more than $1,300,000.00 to creditors. Golden's assets included inventory from

its various stores located in several States with an approximate value of $700,000.00 and real estate located in Catawba County, North Carolina, with an approximate value of $2,000,000.00.

2. That there were over 700 creditors of Golden Enterprises, Inc., and a substantial number of them were located in the New York City area. The Creditors' Committee retained as its Attorneys, Arthur I. Winard and Joseph H. Frier, Jr., of New York City, and J. Carroll Abernethy, Jr., of Hickory, North Carolina.

3. That a Plan of Arrangement was proposed by the Attorney for the Debtor and the same was accepted by the requisite dollar amount and number of creditors through the efforts of the Attorneys for the Creditors' Committee. However, the Debtor was unable to obtain confirmation of the Plan due to a bank withdrawing its support from the Plan. An amended Plan of Arrangement was worked out and approved through the efforts of the Attorney for the Debtor, the Creditors' Committee and its Attorneys. This Plan was not confirmed due to a lack of funds for use as a deposit. During these negotiations, the financial statements prepared by Judd Lawing, Accountant for the Debtor, were utilized by the Attorney for the Debtor, the Creditors' Committee and its Attorneys and the Court.

4. That the Attorney for the Debtor and the Attorneys for the Creditors' Committee were directly involved in the marshalling of assets for the payment to Commercial Credit, Marine Midland Bank, and Matsushita, which payments resulted in those claims being either paid or compromised in full through liquidation or otherwise. The pleadings in those litigated matters are incorporated herein by reference.

5. That at the time the Petition under Chapter XI was filed there was a building owned by the Bankrupt on Tate Boulevard in the City of Hickory that was partially constructed but unfinished. At the time of the filing of the Petition there existed potential liens of contractors, suppliers, and lending institutions that were unsatisfied and which threatened an immediate liquidation of the Bankrupt's estate. Through the efforts of the Attorney for the Debtor, the Attorneys for the Creditors' Committee and the lien holders, a Plan was conceived and approved and implemented whereby the building (45,000 square feet) was completed and rented and the existing mortgages restructured and the real estate refinanced. The prospective tenant and the building code required a sprinkler system which was installed by Jack Sipe Construction Co. It was rented for $56,000.00 annually. Upon completion of the building and the consummation of the refinancing, claims of secured creditors and lien holders were paid or settled as follows:

a. First Citizens Bank & Trust Co. prior construction loan	$275,000.00
b. Growth Enterprises purchase money Deed of Trust	$ 70,000.00
c. Contractor labor and materials to complete	$ 70,000.00
d. Supplies labor and materials	$110,000.00
e. Taxes local ad valorem	$ 18,000.00

The above transactions worked to the direct and substantial benefit of the secured creditors, including first and second mortgage holders. Also, the above transactions were also designed to enhance the equity of the unsecured creditors in the real estate.

6. That while the Debtor was in possession numerous claims of creditors were paid or compromised through a series of Court approved proceedings and through litigation, all with assistance and cooperation of the Creditors' Committee and its Attorneys, and the secured creditors. Generated income for creditors was as follows:

Sale of Thomasville fixtures and inventory	$175,000.00
Sale or ordinary course of business of inventory (net) by Bankrupt and Commercial Credit	$300,000.00
Sale of inventory to Silverman Sales (which purchaser was found by Attorneys Winard and Frier)	$174,000.00

Additional income was generated and paid to secured creditors in the form of rent for twenty-two (22) months (May, 1973 - January, 1975) approximately $450,000.00. These sums were used to pay first mortgages on the Bankrupt's real estate and taxes, which created equity for or otherwise enhanced the position of the second mortgage holders and other creditors. The amended Plan of Arrangement made the sum of $545,000.00 available for payment of secured creditors, which sums were paid.

7. That Golden Enterprises, Inc., operated as a Debtor in possession in pursuit of a confirmation of the Plans of Arrangement during the months of May, 1973, through February, 1975. (This was a period of severe economic recession and a time when real estate values plummeted and foreclosures by lending institutions were numerous.)

8. That as a result of the time, efforts, and planning of the Creditors' Committee, its Attorneys, Attorney for the Debtor, and Jack Sipe Construction Co., the building on a portion of the Debtor's real estate was completed during the lowest point in the economic recession. If completion of the building had not been conceived and implemented, no feasible Plan of Arrangement could have been formulated for unsecured creditors. Without a feasible Plan, the Debtor would have had to convert to straight bankruptcy in late 1973 or early 1974. The real estate would have been sold then, at a time when the economic conditions of the real estate market were such that the property would not have generated enough at auction to satisfy the first lien holders in full. Thus, the diligent efforts of the above averted straight bankruptcy for the Debtor until the recession began to subside and, in so doing, substantially enhanced the value of the real estate and also increased the likelihood of the second lien holders and other creditors receiving equity from a sale of the real estate by generating rent from the improvements to reduce the balances of the first mortgages on the real estate.

9. That Golden Enterprises, Inc., was adjudged a bankrupt on February 14, 1975, and Joe N. Cagle is the duly appointed, qualified and acting Trustee in Bankruptcy.

10. That the Trustee was appointed to conduct the business of the Bankrupt. Among other things the Trustee collected the rents, found tenants for vacant rental property, conducted a sale and resale of the property which sold for more than the first mortgages outstanding thereon, and this Bankruptcy Proceeding has been regular and proper in all respects.

11. That the total receipts during this Bankruptcy Proceeding has been $167,399.17, including accrued interest on savings. The Trustee's monthly reports and final reports reflect the total disbursements of $4,427.85, which were allowed under previous orders of the Court as part of the costs of administration and which are hereby ratified, approved and confirmed. The balance on hand is $162,971.32.

12. That under Section 48 of the Bankruptcy Act, an operating Trustee is entitled to receive such commissions as may be allowed by the Court, but in no event to exceed twice the maximum allowance under normal bankruptcy proceedings. However, the Trustee only requested the normal Trustee's commissions and the same is hereby allowed in the amount of $2,088.99.

13. That Joe N. Cagle, Attorney for the Trustee, filed applications for compensation, pursuant to Bankruptcy Rule 219, for legal services rendered to the Trustee and the Bankrupt Estate, which applications are incorporated herein by reference. This Bankruptcy Proceeding was very complex as appears from the Court files, and it required a great deal of legal skills and expertise to properly serve the Trustee and the said Attorney did render the necessary legal services in a professional and competent manner. The Attorney for the Trustee provided the Trustee with valuable legal opinions and advice through every phase of this very complex and time consuming Bankruptcy Proceeding. The said Attorney conducted title examinations of the Bankrupt's real estate, which was comprised of four developed commercial properties and several vacant tracts with first mortgages on the various tracts from several different lenders and with only one second mortgage (to three parties) on all the tracts. The said Attorney

assisted the Trustee in securing tenants for the rental property. The said Attorney drafted numerous legal documents, including leases, petitions, orders and other pleadings. Among other services, the said Attorney represented the Trustee in three Adversary Proceedings and represented the Trustee at numerous Court hearings and in one Appeal. The services of Attorney Joe N. Cagle as described in the applications on file were necessary and valuable and beneficial to the Trustee and the Bankrupt Estate. The Court is of the opinion that fair and reasonable compensation should be allowed for these valuable services and further that the sum of $9,000.00 (plus expenses in the sum of $207.07) is fair and reasonable for the legal services rendered and the same is hereby allowed.

14. That James M. Gaither, Jr., Attorney for the Bankrupt, filed applications for compensation, pursuant to Bankruptcy Rule 219, for legal services rendered to the Bankrupt Estate with the Court on December 18, 1973, and on May 20, 1974, which applications are incorporated herein by reference. On June 11, 1974, the Court entered an Order awarding Mr. James M. Gaither, Jr., an attorney's fee in the amount of $34,433.75 plus expenses advanced through May 20, 1974, in the amount of $2,240.13, of which fee the sum of $9,000.00 has heretofore been paid to Mr. Gaither. The aforesaid Order is hereby ratified, approved and confirmed. Attorney James M. Gaither, Jr., is entitled to the balance due him under the said Court Order in the amount of $25,433.75 plus expenses in the sum of $2,240.13 as reasonable compensation for the legal services rendered to the Bankrupt Estate in accordance with Bankruptcy Rule 11-31 and said sums are hereby allowed as part of the costs of administration.

15. That James M. Gaither, Jr., Attorney for the Bankrupt, filed an application for compensation, pursuant to Bankruptcy Rule 219, for legal services rendered to the Bankrupt Estate since May 20, 1974, which application is incorporated herein by reference. The services of Attorney James M. Gaither, Jr., were necessary and valuable and beneficial to the Bankrupt Estate. The Court is of the opinion that fair and reasonable compensation should be allowed for these valuable services and further that the sum of $14,000.00 (plus expenses in the sum of $2,576.39) is fair and reasonable for the legal services rendered and the same is hereby allowed pursuant to Bankruptcy Rule 11-31 and as a part of the costs of administration.

16. That Attorneys, J. Carroll Abernethy, Jr., Joseph H. Frier, Jr., and Arthur I. Winard, filed application for compensation, pursuant to Bankruptcy Rule 219, for legal services rendered to the Creditors' Committee and the Bankrupt Estate, which application is incorporated herein by reference. The legal services rendered by Attorneys J. Carroll Abernethy, Jr., Joseph H. Frier, Jr., and Arthur I. Winard were valuable and beneficial to the Creditors' Committee and the Bankrupt Estate. The Court is of the opinion that fair and reasonable compensation should be allowed for the said legal services pursuant to Bankruptcy Rule 11-19.

17. That the sum of $4,625.00 (plus expenses in the sum of $100.00) is fair and reasonable for the legal services rendered by Attorney J. Carroll Abernethy, Jr., and the same is hereby allowed pursuant to Bankruptcy Rule 11-31 and as a part of the costs of administration.

18. That the sum of $8,000.00 (plus expenses in the sum of $946.76) is fair and reasonable for the

legal services rendered by Attorneys Joseph H. Frier, Jr., and Arthur I. Winard, jointly, and the same is hereby allowed pursuant to Bankruptcy Rule 11-31 and as a part of the costs of administration.

19. That Judd Lawing, Certified Public Accountant, of the firm of Lawing, Rowe & Company, filed an application for compensation, pursuant to Bankruptcy Rule 219, for accounting services rendered to the Bankrupt Estate, which application is incorporated herein by reference. The services of Judd Lawing were necessary and valuable and beneficial to the Bankrupt Estate, and the Court is of the opinion that fair and reasonable compensation should be allowed for these valuable services. The sum of $4,137.25 is fair and reasonable for the accounting services rendered by Judd Lawing and the same is hereby allowed as a part of the costs of administration.

20. That Jack Sipe Construction Co., filed an application seeking the sum of $26,451.77 for a sprinkler system which it installed in the warehouse facility constructed on the Bankrupt's property during the Chapter XI proceeding. The installation of this sprinkler system was beneficial to the Bankrupt Estate and necessary in order to complete the said facility and arrange permanent financing on the real estate, all of which was accomplished during the Chapter XI proceeding. The Court is of the opinion that the claim of Jack Sipe Construction Co., in the amount of $26,451.77 is valid and that the same should be allowed as a necessary cost and expense in the preservation of the Bankrupt Estate, and the same is hereby allowed as a part of the costs of administration.

21. That the wage and commissions claim of Charles B. Camp is hereby allowed in the sum of $600.00 and the balance of his Claim No. 465 in the

amount of $26,650.00 is hereby allowed as an unsecured claim.

22. That the correct balance owed to First Citizens Bank and Trust Company is the sum of $174,397.16. All the claims of First Citizens Bank and Trust Company (Claim Nos. 467, 143 and 192) are hereby consolidated and reduced to the sum of $174,397.16, which sum is hereby allowed as an unsecured claim.

23. That Claim No. 436 filed by Marine Midland Leasing Corp., in the amount of $108,521.47, was partially compromised, settled and paid during the Chapter XI proceeding and the same is hereby disallowed with consent of Marine Midland Leasing Corp. Claim No. 477 filed by Marine Midland Leasing Corp. in the amount of $67,495.61 is hereby allowed as an unsecured claim.

24. That Claim No. 144 filed by Jack Sipe Construction Co., in the amount of $81,248.46 is hereby disallowed, with consent of Jack Sipe Construction Co.

25. That the objection of the Trustee to the allowance of Claim No. 471 of The First National Bank of Catawba County in the amount of $48,018.98 is not contested by said creditor. The collateral was sold subject to this lien. The lien of this creditor was not disturbed or affected by the sale and it was not transferred to the proceeds. The creditor was left free to pursue and recover the collateral outside, without any interference of the Bankruptcy Court, and may subject the collateral to the satisfaction of its claim. Further, it appears that this creditor was paid or otherwise satisfied outside the Bankruptcy Proceedings. Thus, this claim is hereby disallowed in toto.

26. That the objection of the Trustee to the allowance of Claim No. 469 of Fidelity Federal Savings and Loan Association in the amount of $176,143.35 is not contested by said creditor. The collateral was sold subject to this lien. The lien of this creditor was not disturbed or affected by the sale and it was not transferred to the proceeds. The creditor was left free to pursue and recover the collateral outside, without any interference of the Bankruptcy Court, and may subject the collateral to the satisfaction of its claim. Further, it appears that this creditor was paid or otherwise satisfied outside the Bankruptcy Proceedings. Thus, this claim is hereby disallowed in toto.

27. That the objection of the Trustee to the allowance of Claim No. 464 of Shelby Savings and Loan Association in the amount of $980,507.02 is not contested by said creditor. The collateral was sold subject to this lien. The lien of this creditor was not disturbed or affected by the sale and it was not transferred to the proceeds. The creditor was left free to pursue and recover the collateral outside, without any interference of the Bankruptcy Court, and may subject the collateral to the satisfaction of its claim. Further, it appears that this creditor was paid or otherwise satisfied outside the Bankruptcy Proceedings. Thus, this claim is hereby disallowed in toto.

28. That Claims Nos. 478, 425 and 482 are duplications and actually represent only one joint claim of William E. Butner, Robert L. McKaughn, Jr., and Jack Sipe Construction Co., in the amount of $360,000.00, represented by a Note and second Deed of Trust on the Bankrupt's real estate. Pursuant to an Adversary Proceeding, the collateral was sold free and clear of this lien with the lien transferred from the property to the proceeds of the sale. The U. S. District Court allowed this creditor to bid at the sale with the amount of his

debt in lieu of putting up cash. Mr. William E. Butner (owner of the entire claim by assignment from the other two creditors) became the highest bidder at the resale of the collateral in the amount of $174,000.00. If the said mortgage holder had actually paid, this money would have been distributed to second mortgage holders, less the Trustee's commissions. Thus, none of the funds in the hands of the Trustee were derived from the sale of the collateral and the balance of this claim is disallowed as a secured claim. The Court is of the opinion that the balance of this claim in the amount of $186,000.00 should be allowed as an unsecured claim to Mr. William E. Butner and the same is hereby allowed.

29. That the Trustee has certain accounts receivable of the Bankrupt totaling $7,437.65, which he has been unable to collect. No offer to purchase the accounts receivable is available and the Court is of the opinion that the Trustee ought to be allowed to abandon the same.

CONCLUSIONS OF LAW

1. That this Bankruptcy Proceeding has been regular and proper in all respects.

2. That the services of Attorney Joe N. Cagle were necessary and valuable and beneficial to the Trustee and the Bankrupt Estate and that fair and reasonable compensation should be allowed for these valuable services and further that the sum of $9,000.00 (plus expenses in the sum of $207.07) is fair and reasonable for the legal services rendered and the same is hereby allowed as part of the costs of administration.

3. That on June 11, 1974, the Court entered an Order awarding Mr. James M. Gaither, Jr., an

attorney's fee in the amount of $34,433.75 plus expenses advanced through May 20, 1974, in the amount of $2,240.13, of which fee the sum of $9,000.00 has heretofore been paid to Mr. Gaither. The aforesaid Order is hereby ratified, approved and confirmed. Attorney James M. Gaither, Jr., is entitled to the balance due him under the said Court Order in the amount of $25,433.75 plus expenses in the sum of $2,240.13 as reasonable compensation for the legal services rendered to the Bankrupt Estate in accordance with Bankruptcy Rule 11-31 and said sums are hereby allowed as part of the costs of administration.

4. That the services of Attorney James M. Gaither, Jr., were necessary and valuable and beneficial to the Bankrupt Estate and that fair and reasonable compensation should be allowed for these valuable services and further that the sum of $14,000.00 (plus expenses in the sum of $2,576.39) is fair and reasonable for the legal services rendered and the same is hereby allowed pursuant to Bankruptcy Rule 11-31, and as a part of the costs of administration.

5. That the legal services rendered by Attorneys J. Carroll Abernethy, Jr., Joseph H. Frier, Jr., and Arthur I. Winard were valuable and beneficial to the Creditors' Committee and the Bankrupt Estate and that fair and reasonable compensation should be allowed for the said legal services pursuant to Bankruptcy Rule 11-19.

6. That the sum of $4,625.00 (plus expenses in the sum of $100.00) is fair and reasonable for the legal services rendered by Attorney J. Carroll Abernethy, Jr., and the same is hereby allowed pursuant to Bankruptcy Rule 11-31 and as a part of the costs of administration.

7. That the sum of $8,000.00 (plus expenses in the sum of $946.76) is fair and reasonable for the legal services rendered by Attorneys Joseph H. Frier, Jr., and Arthur I. Winard, jointly, and the same is hereby allowed as a part of the costs of administration, pursuant to Bankruptcy Rule 11-31.

8. That the services of Judd Lawing were necessary and valuable and beneficial to the Bankrupt Estate and that fair and reasonable compensation should be allowed for these valuable services and further that the sum of $4,137.25 is fair and reasonable for the accounting services rendered by Judd Lawing and the same is hereby allowed as a part of the costs of administration.

9. That the claim of Jack Sipe Construction Co., in the amount of $26,451.77 is valid and that the same should be allowed as a necessary cost and expense in the preservation of the Bankrupt Estate, and the same is hereby allowed as a part of the costs of administration.

10. That the wage and commissions claim of Charles B. Camp is hereby allowed in the sum of $600.00 and the balance of his Claim No. 465 in the amount of $26,650.00 is hereby allowed as an unsecured claim.

11. That the correct balance owed to First Citizens Bank and Trust Company is the sum of $174,397.16. All the claims of First Citizens Bank and Trust Company (Claim Nos. 467, 143 and 192) are hereby consolidated and reduced to the sum of $174,397.16, which sum is hereby allowed as an unsecured claim.

12. That Claim No. 438 filed by Marine Midland Leasing Corp., in the amount of $108,521.47 was partially compromised, settled and paid during the Chapter XI proceeding and the same is hereby disallowed with consent of Marine Midland Leasing Corp. Claim No. 477 filed by Marine Midland Leasing Corp. in the amount of $67,495.61 is hereby allowed as an unsecured claim.

13. That Claim No. 144 filed by Jack Sipe Construction Co., in the amount of $81,246.46 is hereby disallowed, with consent of Jack Sipe Construction Co.

14. That Claim No. 471 of The First National Bank of Catawba County, in the amount of $48,018.98 is hereby disallowed.

15. That Claim No. 489 of Fidelity Federal Savings and Loan Association, in the amount of $176,143.35 is hereby disallowed.

16. That Claim No. 464 of Shelby Savings and Loan Association, in the amount of $176,143.35 is hereby disallowed.

17. That Claim Nos. 476, 425 and 462 are duplications and actually represent only one joint claim of William E. Butner, Robert L. McKaughn, Jr., and Jack Sipe Construction Co., in the amount of $360,000.00 represented by a Note and second Deed of Trust on the Bankrupt's real estate. Pursuant to an Adversary Proceeding, the collateral was sold free and clear of this lien with the lien transferred from the property to the proceeds of the sale. The U. S. District Court allowed this creditor to bid at the sale with the amount of his debt in lieu of putting up cash. Mr. William E. Butner (owner of the entire claim by assignment from the

other two creditors) became the highest bidder at the resale of the collateral in the amount of $174,000.00. Thus, none of the funds in the hands of the Trustee were derived from the sale of the collateral and the balance of this claim is disallowed as a secured claim. The Court is of the opinion that the balance of this claim in the amount of $186,000.00 should be allowed as an unsecured claim to Mr. William E. Butner and the same is hereby allowed.

18. That the Trustee has certain accounts receivable of the Bankrupt totaling $7,437.65, which he has been unable to collect. No offer to purchase the accounts receivable is available and the Court concludes that the Trustee ought to be allowed to abandon the same.

19. That all other findings of fact are incorporated herein.

NOW, THEREFORE, it is ORDERED, ADJUDGED AND DECREED as follows:

1. That the disbursements of the Trustee in the amount of $4,427.85, which were allowed under previous orders of the Court, are hereby ratified, approved and confirmed as part of the costs of administration.

2. That the Trustee be and he is hereby allowed Trustee's commissions in the sum of $2,088.99 as a part of the costs of administration.

3. That Joe N. Cagle, Attorney for the Trustee, be and he is hereby allowed the sum of $9,000.00 as attorney's fee and the sum of $207.07 for expenses advanced, as a part of the costs of administration.

4. That James M. Gaither, Jr., Attorney for the Bankrupt, be and he is hereby allowed an attorney's fee in the sum of $25,433.75 and the sum of $2,240.13 for expenses advanced (representing the balance due Mr. Gaither under the Court Order dated June 11, 1974), as a part of the costs of administration.

5. That James M. Gaither, Jr., Attorney for the Bankrupt, be and he is hereby allowed the sum of $14,000.00 as attorney's fee and the sum of $2,576.39 for expenses advanced (for legal services rendered since May 20, 1974), as a part of the costs of administration.

6. That J. Carroll Abernethy, Jr., Attorney for the Creditors' Committee be and he is hereby allowed the sum of $4,625.00 as an attorney's fee and the sum of $100.00 for expenses advanced, as a part of the costs of administration.

7. That Joseph H. Frier, Jr., and Arthur I. Winard, jointly, Attorneys for the Creditors' Committee, be and they are hereby allowed the sum of $8,000.00 as attorneys' fees and the sum of $946.76 for expenses advanced, as a part of the costs of administration.

8. That Judd Lawing, Certified Public Accountant, Accountant for the Bankrupt, be and he is hereby allowed the sum of $4,137.25 for accounting services, as a part of the costs of administration.

9. That Jack Sipe Construction Co., be and it is hereby allowed the sum of $26,451.77 for the installation of a sprinkler system during the Chapter XI proceeding, as a part of the costs of administration.

10. That the wage and commissions claim of Charles B. Camp is hereby allowed in the sum of

$600.00 and the balance of his Claim No. 465 in the amount of $26,650.00 is hereby allowed as an unsecured claim.

11. That the correct balance owed to First Citizens Bank and Trust Company is the sum of $174,397.16. That the claims of First Citizens Bank and Trust Company (Claim Nos. 467, 143 and 192) are hereby consolidated and reduced to the sum of $174,397.16, which sum is hereby allowed as an unsecured claim.

12. That Claim No. 436 filed by Marine Midland Leasing Corp., in the amount of $108,521.47, was partially compromised, settled and paid during the Chapter XI proceeding and the same is hereby disallowed with consent of Marine Midland Leasing Corp., and that Claim No. 477 filed by Marine Midland Leasing Corp., in the amount of $67,495.61 is hereby allowed as an unsecured claim.

13. That Claim No. 144 filed by Jack Sipe Construction Co., in the amount of $81,248.46 is hereby disallowed, with consent of Jack Sipe Construction Co.

14. That Claim No. 471 of The First National Bank of Catawba County, in the amount of $48,018.98 is hereby disallowed.

15. That Claim No. 469 of Fidelity Federal Savings and Loan Association, in the amount of $176,143.35, is hereby disallowed.

16. That Claim No. 464 of Shelby Savings and Loan Association, in the amount of $980,507.02, is hereby disallowed.

17. That the balance of the $360,000.00 claim of Mr. William E. Butner, in the amount of $186,000.00

is disallowed as a secured claim and it is hereby allowed as an unsecured claim.

18. That the Trustee is hereby allowed to abandon the Bankrupt's accounts receivable as described in the Final Report.

19. That the Motion For Distribution of Funds filed by William E. Butner is hereby denied.

20. That except as hereinabove modified and amended, the Final Report of the Trustee is hereby approved, ratified and confirmed.

This the 1st day of July, 1976.

Marvin R. Wooten
U. S. Bankruptcy Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
STATESVILLE DIVISION

Bankruptcy Number ST-B-73-6

In Re:

GOLDEN ENTERPRISES, INC.,
Bankrupt.

MEMORANDUM AND ORDER

This matter is before the Court upon an appeal from an order of the Bankruptcy Court dated and entered on July 1, 1976, whereby William E. Butner was found to be an unsecured creditor of the Bankrupt, Golden Enterprises, Inc. The appellant contends that his claim should be given secured status and paid in full out of funds received by the Trustee from rents and profits derived from real estate upon which he held a second mortgage.

The appeal was heard at the August 1976 term at Statesville and after a careful examination of the records and a consideration of the briefs and oral arguments, the Court now enters its findings and conclusions.

On May 4, 1973 Golden Enterprises, Inc., filed a petition in bankruptcy for an arrangement under Chapter XI of the Bankruptcy Act. A plan was never confirmed and the Bankrupt operated as a Debtor in possession from the date of filing until February 14, 1975, when it was adjudged a bankrupt and a Trustee was appointed. During the pendency of the petition under Chapter XI and upon the application of the attorney for the Bankrupt, Simon Joseph Golden was

appointed by the Bankruptcy Court as Agent to collect the rents from the real estate owned by Golden Enterprises, Inc., and to disburse the proceeds to the payment of (1) federal and state income taxes; (2) monthly payments to first mortgages; (3) ad valorem property taxes; (4) fire insurance premiums, and (5) interest and principal on second mortgages. After the straight bankruptcy adjudication the Trustee took charge of the real estate and collected the rents. During the administration of the Bankrupt's estate the Trustee collected some $167,309.17 in rents and accured interest, of which $162,971.32 remains on hand after authorized disbursements. The question in controversy here is who gets these funds, the holder of the second mortgage, or the bankrupt's estate? If it goes to the estate, the bulk of it will be used to pay court costs and attorney fees.

At all times pertinent to this appeal the appellant, William E. Butner, together with Robert L. McKaughn, Jr., and Jack Sipe Construction Company, held a second mortgage on real estate owned by the Bankrupt securing an indebtedness of $360,000.00. By assignment, Butner is the sole owner and holder of the note and is entitled to any recovery had thereon. Pursuant to an adversary proceeding the real estate was ordered sold subject to the first mortgage but free and clear of the second mortgage, with the lien of the second mortgage being transferred from the property to the proceeds of the sale. By the terms of the order Butner was permitted to bid on the property at the sale the amount of his debt in lieu of a cash bid. At the sale he became the last and highest bidder for the property with a bid of $174,000.00, leaving a balance of $186,000.00 unsatisfied.

The Bankruptcy Judge found that the appellant's bid and purchase of the property extinguished his

secured claim, and that the balance due on his note would constitute nothing more than an unsecured claim. The Judge reasoned that had the appellant actually submitted a cash bid, the money would have been distributed to him as the holder of the second mortgage, less the Trustee's commissions and the cost of sale, thereby extinguishing the secured debt.

Since there appears to be no dispute as to the facts, the sole question for determination by this Court is whether the Bankruptcy Judge erred in his holding that as a matter of law the appellant's secured claim does not extend to the income derived from the rental of the real estate during bankruptcy administration.

There appears to be considerable disagreement between the Circuit Courts of Appeals on this issue. In Fidelity Bankers Life Insurance Co. v. Williams, 506 F.2d 1242 (4th Cir. 1974), Chief Judge Haynsworth stated:

> "Some courts, notably the Third and Seventh Circuits, hold that a secured creditor may recover the rental income. See, e.g., In re Pittsburgh-Duquesne Development Co., 482 F.2d 243, 246 (3d Cir. 1973); Central Hanover Bank & Trust Co. v. Philadelphia & Reading Coal & Iron Co., 99 F.2d 642 (3d Cir. 1938); In re Wakey, 50 F.2d 869 (7th Cir. 1921). Those courts view the issue as a contest between the secured creditors and the unsecured ones for whom the bankruptcy court operates the estate. Since the rental income is additional security for the mortgage loan, the Third and Seventh Circuits equitably shift the income from the unsecured to the secured creditors.
>
> "Other courts of appeals, including the Eighth

and Ninth Circuits, reject this approach. E.g., Tower Grove Bank & Trust Co. v. Weinstein, 119 F.2d 120 (8th Cir. 1941); In re Hotel Saint James Co., 65 F.2d 82 (9th Cir. 1933); see In re Humeston, 83 F.2d 187 (2d Cir. 1936). Those authorities have found that the mortgagee has no right to the rents because, under the mortgage terms, state courts require the mortgagee to take possession in order to fix his right to the rents. A mortgagee, however, cannot take possession and collect rents once the bankruptcy court has assumed control of the property. Accordingly, those courts substitute other actions to secure rights in the rental income for the contractual entry of possession and collection of rents. If the mortgagee has petitioned the bankruptcy court for a sequestration order, obtained the appointment of a receiver to collect the rents, or secured the court's consent to foreclose, the Eighth and Ninth Circuits allow him to recover the rental income during the bankruptcy administration. See, e.g., Pollack v. Sampsell, 174 F.2d 415 (9th Cir. 1949); Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930); 4A Collier, supra, § 70.16, at 161-63."

The issue in Williams was identical with the question here but the Court determined that the mortgagee was entitled to the rents on the basis of a provision in the mortgage and thereby did not reach and decide our basic issue. However, the Court did go far enough to blaze some trails to head us in the right direction when it held that:

> "Although Fidelity pursued its abandonment petition, it did not take the steps required by the Eighth and Ninth Circuits to fix its right to

the rental income. Its failure to take action, however, has not caused difficulty in ascertaining the amount of the net rental income from operating the property. Nonetheless, the supplemental agreement between Fidelity and O'Neil removes this case from the primary area of dispute between the other courts of appeals. That agreement assigned the income to Fidelity without requiring it to take possession of the building." (Page 1243)

It thus appears that the Court of Appeals for the Fourth Circuit would follow the approach of the Eighth and Ninth Circuits. In following this approach four factors should be taken into consideration: (1) the nature of the mortgage transaction under applicable state law; (2) the terms of the mortgage itself; (3) the acts of the parties thereunder, and (4) whether equitable consideration as applied by the federal bankruptcy court may alter the result. 4A, Collier on Bankruptcy, § 70.16 (1976).

Under North Carolina law a mortgagor is deemed to be the owner of the land subject to the debt, and even after default, he is entitled to rents and profits from it until the mortgagee takes possession. Gregg v. Williamson, 246 N.C. 356, 98 S.E.2d 481 (1957); Kistler v. Development Co., 205 N.C. 755. 172 S.E. 413 (1934); Parker Co. v. Bank, 204 N.C. 432, 168 S.E. 681 (1933).

In Kistler v. Development Co., supra, the court held:

"In the absence of a stipulation to the contrary a mortgagor of real property who is permitted to retain possession is entitled to the rents and profits. Credle v. Ayers, 126 N. C., 11. As

between the mortgagor and the mortgagee equity makes the mortgage a charge upon the rents and profits when the mortgagor is insolvent and the security is inadequate (Carr v. Dail, 114 N. C., 284), but the prevailing rule is that a mortgagee is not entitled to rents until entry is made or a suit for foreclosure is begun. Killebrew v. Hines, 104 N. C., 182; Parker Co. v. Bank, 204 N.C. 432. In the latter case it was held that the mortgagee's right to collect the rents and income of mortgaged property arises only after the mortgagee or trustee has taken possession either by consent or by an order or decree of the court. There a receiver had been appointed in an action for the foreclosure of the mortgage and as the amount realized from a sale of the property was not sufficient to pay the mortgage debt the rents were properly applied in payment of the deficiency."

The question then arises as to whether the appellant, the mortgage holder, took the necessary steps to obtain possession of the property or to foreclose his mortgage. He contends that he and the holders of the first mortgages attempted to no avail on numerous occasions to get the bankruptcy court to abandon the real estate to them so they could proceed to foreclose. As it turned out, the real estate when sold at public sale did not sell for enough to pay the secured claims and therefore, in retrospect, it appears that the property should have been abandoned to the secured creditors. This was not done, and it was sold by order of the bankruptcy court. It was necessary for the appellant to appeal to this Court in order to obtain the right to use his note in connection with his bid on the property covered by his mortgage at the sale ordered by the Bankruptcy Judge and conducted by the Trustee.

As already noted by the Court, on April 17, 1974, James M. Gaither, attorney for the Debtor, moved for the appointment of an agent or receiver to collect the rental income from the real estate and to apply the same to the payment of taxes, mortgage payments, and insurance. In his Motion, Mr. Gaither states:

> " . . . That several secured parties including Shelby Savings and Loan Association, Jack Sipe Construction Company, William E. Butner, and Robert L. McKaughn, Jr., as well as the Creditors' Committee, have requested that the income derived from rentals, as well as the books and records of the company with regard to its real estate, be placed in the hands of a court-appointed individual with directions to collect the rents, make all mortgage payments, pay taxes, insurance, and repairs and accumulate excess cash flow for the benefit of secondary lienholders and the unsecured creditors."

It therefore appears to this Court that the appointment of Mr. Golden to collect the rents was in effect the appointment of a receiver as authorized under Rule 201 of the Rules of Bankruptcy Procedure. The files show that this appointment resulted from the request of the secured creditors, including the appellant, Mr. Butner, who were attempting to apply these funds to the claims they held against the Debtor. Admittedly, the Trustee was subsequently appointed in February of 1975, thereby terminating the appointment of the receiver but the Trustee continued to collect these rents and profits, and to hold them in accordance with the original order. It would have been an exercise in futility for the appellant to have moved for the appointment of a receiver to collect and sequester these rents since that was already being done.

It therefore appears that the appellant did all that he could do to obtain possession of the property and proceed to foreclosure as well as to have the rents collected and sequestered, and has met the requirements set forth in Williams, Parker Co. and Development Co. supra, necessary to extend his secured status to the rents from the property.

Turning to the second and third factors which should be considered, the Court finds nothing in the terms of the mortgage or in the acts of the parties to aid in the determination of this issue.

The final factor is whether equitable consideration as applied by the bankruptcy court may alter the results. The Court finds no difficulty in determining that equity requires that rents collected under the circumstances of this case should go to the secured lienholders rather than to the unsecured creditors. However, in this case it appears to be a contest between the holder of the second mortgage on the one hand, and the trustee and attorneys for the Bankrupt and Creditors Committee on the other hand. The attorneys admitted at the hearing that the court costs, the trustee and attorney fees as approved by the bankruptcy court would consume most of the rental funds collected and on hand. The files disclose that the bankrupt's estate owned sizeable quantities of personal property, and the Court is at a loss to understand why the bulk of the costs and fees has been relegated for payment out of the rents from the real estate.

It is an accepted rule that in a bankruptcy sale free of liens and encumbrances the proceeds are chargeable with the actual cost of the sale plus costs reasonably incurred in the preservation of the property and the portion of the administration expenses

that may be properly attributed to the sale. However, the lien holder cannot be charged with additional expenses or the general cost of administration of the bankrupt's estate such as costs of operating the business or the expenses and losses thereof. Collier's Volume 4-A at Page 1223.

In the instant case, the Court has found that the appellant's secured status extended to the rents and profits derived from the property during the administration of the bankrupt's estate. Applying the aforementioned rule to this finding, it would be improper to charge these rents with the fees and costs of the entire estate approved by the Bankruptcy Judge. Therefore, it is the opinion of this Court that the case should be remanded on this point for a determination of the cost of sale and of the costs reasonably incurred in the preservation of this property. Also, a finding should be made as to what administrative expenses are properly attributable to this sale. It is the conclusion of this Court that only these amounts are properly chargeable against these rents, and that the balance is rightfully owing to the appellant under his security interest.

IT IS, THEREFORE, ORDERED that the Bankruptcy Judge's finding of the appellant's unsecured status as to the rents derived from the encumbered property at issue during the bankruptcy be, and the same is hereby reversed and vacated, and the case is remanded for a determination of what costs and fees are properly chargeable against these rents.

The Court has by separate findings and Order directed the payment of the sum of $26,451.77 to Jack Sipe Construction Company as the sum due and payable for the completion of a building on the real estate. This work was done by order of the Bankruptcy Court

and by consent of these parties and inured to the benefit of the creditors, secured and unsecured.

This the 12th day of November, 1976.

Woodrow W. Jones
Chief Judge

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

(Argued October 4 - decided December 8, 1977)

Docket Nos. 77-1138 and 77-1151

Golden Enterprises, Inc., and William E. Butner v. United States of America

and

Joe Cagle, Trustee in Bankruptcy for Golden Enterprises, Inc., et al. v. William E. Butner

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BRYAN, Senior Circuit Judge; WINTER and THOMSEN (sitting by designation), Judges.

Joe N. Cagle (Cagle and Houck on brief) and James M. Gaither, Jr., and (J. Carroll Abernethy, Jr., on brief) for Appellants in 77-1151.

Carleton D. Powell, Attorney, Department of Justice Tax Division (Gilbert E. Andrews & Crombie J. Garrett, Attorneys, Department of Justice Tax Division; Myron C. Baum, Acting Assistant Attorney General and Keith S. Snyder, United States Attorney on brief) for Appellant in 77-1138.

William E. Butner for Appellee in 77-1138 and 77-1151.

WINTER, Circuit Judge:

The question we must decide is which of the mortgagee or the bankrupt estate is entitled to rents realized from mortgaged property between the time of the mortgagor's bankruptcy and foreclosure of the

mortgage. On the facts before us, we hold that they go to the bankrupt estate. We reverse the district court and reinstate the disposition made by the bankruptcy judge.

I.

Golden Enterprises, Inc. (Golden) was the owner of several parcels of real estate located in North Carolina on which first mortgages were given to several financial institutions and a second mortgage given to William E. Butner and others, whose interests Butner later acquired, to secure a debt of $360,000. Golden filed a petition in bankruptcy for an arrangement under Chapter XI of the Bankruptcy Act (11 U.S.C. §§ 701-799). It operated as a debtor in possession for a time, but a plan of arrangement was never confirmed. On February 14, 1975, the proceeding was transformed into a liquidating bankruptcy.

While the Chapter XI petition was pending, the bankruptcy court appointed an agent to collect Golden's rents and to apply them to the payment of the taxes, insurance, interest and principal payments due on the mortgages. When the straight bankruptcy ensued, the trustee collected the rents. The trustee made some authorized disbursements from the rents he collected. By direction of the bankruptcy court, however, he made no payments on the mortgages. After the authorized disbursements, the sum of $162,971.32 remained in the hands of the trustee and it is the fund which is the subject of this appeal.

The mortgages did not provide any security interest for the mortgagees in the rents. The mortgages were in default by the time that Golden was adjudicated bankrupt. At the first meeting of creditors,

Butner requested that the property be abandoned to him subject to the first mortgages. The trustee was willing to accede to Butner's request, and the trustee suggested this procedure as one of several alternatives for winding up the bankruptcy since there were substantially no other assets for general creditors. He also suggested, as another alternative, a sale or foreclosure by him as trustee of the second mortgage--that is, a sale subject to the first mortgages with the lien of the second mortgage transferred to the proceeds of the sale. When the bankruptcy judge indicated a preference for the latter, the trustee formally sought and obtained authority for a public sale subject to the first mortgages, with the rights of other lienholders transferred to the proceeds of sale. Although the property sold, the district court, upon Butner's appeal, ordered a resale of the property with permission to Butner, if he was the successful bidder, to make payment by satisfying the debt due him in lieu of cash. Butner was the successful bidder at the second sale. The amount of the debt due him at that time was $360,000. He bid $174,000 for the properties and paid for them by consuming part of the debt due him, leaving a balance of $186,000 of the amount secured by his second mortgage unsatisfied.

The deed from the trustee to Butner provided that "[t]he accrued rents and the right to collect unpaid accrued rents from [the subject property] are hereby expressly not conveyed, but are reserved to the [trustee]." Although Butner never requested that the rents be sequestered for his benefit prior to the sale, he claimed, before the bankruptcy judge, that the unsatisfied debt due him ($186,000) should be given secured status and paid from the fund of net rents collected after bankruptcy was adjudicated. The bankruptcy judge rejected the contention and ruled that the order of sale transferred the lien of the

second mortgage to the proceeds of sale and that Butner should be treated as a general creditor with respect to his unsatisfied security interest. The district court, however, ruled that, notwithstanding the absence of a provision in the second mortgage relating to rents before foreclosure and Butner's failure to seek a sequestration of the rents for his benefit, Butner was entitled to the fund. It reached this conclusion on both legal and equitable grounds.

The trustee and creditors, including the United States (with claims for unpaid taxes amounting to approximately $50,000), appealed. We think the bankruptcy judge was correct. We therefore reverse the district court's order and remand for reinstatement of the bankruptcy judge's determination.

II.

The question of a secured creditor's right to income generated by the secured property during bankruptcy has produced a split of opinion among the circuits. Although we have not ruled on this issue, a recent opinion by Judge Haynsworth in Fidelity Bankers Life Insurance v. Williams, 506 F.2d 1242, 1243 (4 Cir. 1974), ably summarizes the two competing theories:

> Other courts of appeals have disagreed about whether a lien creditor is entitled to the income from property during bankruptcy administration. . . . Some courts, notably the Third and Seventh Circuits, hold that a secured creditor may recover the rental income . . . . Those courts view the issue as a contest between the secured creditors and the unsecured ones for whom the bankruptcy court operates the estate. Since the rental income is additional security

for the mortgage loan, the Third and Seventh Circuits equitably shift the income from the unsecured to the secured creditors.

> Other courts of appeals, including the Eighth and Ninth Circuits, reject this approach . . . . Those authorities have found that the mortgagee has no right to the rents because, under the mortgage terms, state courts require the mortgagee to take possession in order to fix his right to the rents. A mortgagee, however, cannot take possession and collect rents once the bankruptcy court has assumed control of the property. Accordingly, those courts substitute other actions to secure rights in the rental income for the contractual entry of possession and collection of rents. If the mortgagee has petitioned the bankruptcy court for a sequestration order, obtained the appointment of a receiver to collect the rents, or secured the court's consent to foreclose, the Eighth and Ninth Circuits allow him to recover the rental income during the bankruptcy administration. See, e.g., Pollack v. Sampsell, 174 F.2d 415 (9th Cir. 1949); Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930); 4A Collier, supra § 70.16, at 161-63.

We now align ourselves with the Eighth and Ninth Circuits. Their view seems preferable because it best ensures that the outcome in federal court will parallel the result that would obtain in state court had bankruptcy proceedings not been instituted. We look to see what Butner's rights were under state law and whether he took steps which are the analogue of what state law requires.

III.

Under North Carolina law, absent a special provision giving the mortgagee a right to receive the rents, a mortgagee must take possession of the mortgaged property in order to be entitled to the rents which issue therefrom. Gregg v. Williamson, 246 N.C. 356, 98 S.E.2d 491 (1957); Kistler v. Development Co., 205 N.C. 755, 1972 S.E. 413 (1934); Killibrew v. Hines, 104 N.C. 182 (1889). Butner's second mortgage gave him no right to the rents before foreclosure, and because of the bankruptcy he did not, of course, take possession of the mortgaged property. We turn then to the steps he took before the trustee's sale.

The record reflects no request by Butner during bankruptcy for a sequestration of rents or for the appointment of a receiver. The district court found that such a request "would have been an exercise in futility . . . since that was already being done," but this statement is erroneous. Of course, there had been a receiver until the adjudication in bankruptcy and he had applied the rents collected, inter alia, to the payment of interest and principal on the mortgages. But the adjudication of bankruptcy and the appointment of a trustee terminated the prior receivership, Bankruptcy Rule 201 (a), and thereafter the trustee collected the rents for the bankrupt estate. Moreover, he was specially instructed by the bankruptcy court not to make any mortgage payments. Manifestly, what the district court thought was being done was not being done; and had Butner desired it to be done, it was incumbent on him to make a specific request for the appointment of a receiver and the sequestration of rents.

Similarly, the record reflects no formal action on the part of Butner to proceed with foreclosure in

compliance with Bankruptcy Rule 701. He had, of course, made several informal requests that the property be abandoned, but when they were not granted he pursued the matter no further. Indeed, he made such a request of the bankruptcy judge at a time after the adjudication, when approximately $50,000 in rents had been collected by the trustee; but at that time he stated he would waive any claim to the accrued rents. When the trustee formally requested authority to sell the property, Butner was made an adversary party to the request. He filed no answer, although he could have requested abandonment, permission for him to foreclose under state law, or a determination of the priority of his lien on the rents. In short, we can find no sufficient indicia that Butner would have proceeded to assert a security interest in the rents had bankruptcy not ensued.

IV.

The district court, in reversing the order of the bankruptcy judge, stated, "the Court finds no difficulty in determining that equity required that rents collected under the circumstances of this case should go to the secured lienholders rather than to unsecured creditors." The difficulty that we have is that the district court failed to articulate the equitable considerations that it thought required the result that it reached.

Our examination of the record does not persuade us that there is any significant equitable consideration which requires a resolution of the dispute in favor of one party over another. Butner ostensibly lost on his second mortgage. Yet we are told that he has profited from ultimate disposition of the property. If the fund inures to the benefit of the bankrupt estate, it may well be, as the district court feared, that it will be largely consumed by attorneys' fees; yet the record reflects

that substantial legal services were performed.

We therefore think that the decision should proceed from the legal considerations discussed in Parts II and III hereof. If equity has a part in the resolution of a question of this type--an issue on which we express no view--equity does not supply the answer here.

REVERSED AND REMANDED.

Albert V. Bryan, Senior Circuit Judge, dissenting:

I would affirm on the discriminating opinion of the District Judge, In Re: Golden Enterprises, Bankrupt, No. ST-B-73-6 (November 16, 1976).

Despite the recital of other reasons, the majority decision actually turns on the single axis: that appellee, the second mortgagee, failed to renew "during bankruptcy" a request made during the arrangement phase for a sequestration of rents for his benefit. The term "bankruptcy" is used in its technical reference to the stage of the case after adjudication of bankruptcy upon failure of the arrangement plan.

I.

This point was initially made at trial by the appellants, but overruled by the District Judge for the reason that the requirement of a second request would have been the exaction of a procedure he deemed futile, that is, useless as unnecessary "since that was already being done", i.e., it had been sought and ordered by the Bankruptcy Judge. But the majority terms this statement erroneous because, although this had occurred in the arrangement proceeding, the request had not been renewed after the adjudication, hence

not "during bankruptcy". The facts, I think, sustain the District Judge and reveal the majority as sacrificing substance to form, for in regard to the request and order, there was no such decisive break in the two stages of the case as to warrant this sacrifice.

On May 4, 1973, the petition for an arrangement was filed by Golden Enterprises and on June 27, 1973 Joe N. Cagle was appointed "standby trustee", that is, to serve as trustee in bankruptcy in the event of the failure of the arrangement plan, as authorized by the statute, 11 USC 738. Thereafter, April 17, 1974, the Debtor's attorney moved the Bankruptcy Judge "for an Order appointing a named individual to function as agent in collecting rental income of Golden Enterprises, Inc. and applying the funds to those debts approved for payment by this Court". The next day the order was entered naming Simon Joseph Golden as agent "to collect rents and to apply the proceeds under the supervision of the Court". Among the applications so ordered was one to the "5. Interest and principal on secondary mortgages" which, of course, included appellee Butner's mortgage. Further, the agent was directed not only to file monthly reports to the Court, but also to the "second mortgage holders", of his receipts, expenditures and "accumulations".

No modification of this order occurred before the adjudication of bankruptcy which was made 10 months later, February 14, 1975. Therein Joe N. Cagle was appointed trustee of the property of the Debtor. As heretofore noted, he had been named earlier to occupy this position and did so throughout the filing of the request for an agent to collect rents and the use of them towards payment of the principal and interest of the second mortgage. Highly significant, moreover, is that the trustee after adjudication was directed, inter alia, "to collect and receive all

rents . . . and to hold and retain all moneys thus received to the end that the same may be applied under this or different orders of this Court . . . ." This included, of course, the sequestration order--as a "different" order--for it emanated from the same court in a component of the same suit.

True, Bankruptcy Rule 201 provides that the appointment of a receiver (agent here) shall be terminated when the trustee qualifies. However, this termination does not wipe out the request for the sequestration; nor does it annul the order for the application of the rents to the second mortgage. Only the collector is changed, but that change would not alter the rights of a creditor which were fixed by an order during the arrangement stage. The agent would simply be supplanted by the trustee. The first order has equal standing, by virtue of 11 USC 752, of any order entered in a voluntary bankruptcy case after adjudication, and a petition for an arrangement is the equivalent of a petition for voluntary bankruptcy. 11 USC 752 and 778(a)(2). Thus this order remained intact and no reassertion of it was demandable.

With deference I suggest that the majority misconceives the operation of the arrangement provisions, contending that what is ordered during that period is vacated or nullified by the subsequent adjudication. As just mentioned this is gainsaid by the statute, §752, declaring that an order passed therein before adjudication, has the same standing as one passed in a voluntary bankruptcy after adjudication. In truth, there is but a single proceeding. The arrangement phase is simply a prefatory consideration in relation to bankruptcy. The same petition at once serves both; the trustee for both is chosen at the commencement of the arrangement; and both are simultaneously considered by the Bankruptcy Judge. Hence orders are

frequently common to both.

II.

Appellee Butner is chided in the majority opinion for not taking "formal action" to obtain foreclosure of his mortgage by an adversary proceeding under Bankruptcy Rule 701. Likewise, he is taken to task for not filing an opposing answer to the trustee's application to sell the property. Both of these reprovals are extinguished by the fact that, as the majority earlier noted, Butner had already asked for abandonment of the property to him subject to prior mortgages. It was in this context that he stated he would waive any claim, as the majority would point up; manifestly, his business judgment taught that the abandonment of the property to him was more advantageous than the benefits to be derived from the rentals. Instead of ordering abandonment, the trustee obtained authorization to sell the property at public auction, which he did. Surely, again, further action by Butner would have been futile.

III.

Finally, the proposed opinion notices the District Judge's statement that "the Court finds no difficulty in determining that equity required that rents collected under the circumstances of this case should go to the secured lienholders rather than to unsecured creditors". Rather than to dispose of the considerations in the mind of the District Judge by simply referring to his failure to articulate these equities, I would remand for a hearing on them. Particularly in respect to equities, I would not charge Butner with any success he may have had with the property after he had bought it and it was out of the case.

For the foregoing reasons I cannot join in the majority opinion.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Docket Nos. 77-1138 and 77-1151

Golden Enterprises, Inc., and William E. Butner v.
United States of America

and

Joe Cagle, Trustee in Bankruptcy for Golden Enterprises, Inc., et al. v. William E. Butner

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ORDER

Upon consideration of the appellee for a petition for rehearing, by counsel,

IT IS ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Winter with the concurrance of Judge Thomsen. Judge Bryan dissents.

For the Court,
William K. Slate, II
Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Docket Nos. 77-1138 and 77-1151

Golden Enterprises, Inc., and William E. Butner v.
United States of America

and

Joe Cagle, Trustee in Bankruptcy for Golden Enterprises, Inc., et al. v. William E. Butner

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ORDER

Upon consideration of a motion of the appellee, for stay of mandate pending application to the United States Supreme Court for a writ of Certiorari,

IT IS ORDERED that the motion is DENIED.

For the Court - by Direction.
William K. Slate, II
Clerk